Whiteside & Associates

TRANSPORTATION REPORT

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To: The Montana Wheat & Barley Committee

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INTERMODAL UPDATE: RAILROADS LOAD SECOND-HIGHEST WEEKLY INTERMODAL CONTAINERS VOLUME OF 2011 - AUGUST 20, 2011

Major railroads in the U.S., Canada and Mexico picked up 1.3 percent more intermodal containers and trailers in the week of August 20th than the week previous, for their second-highest total of 2011. This shows that Intermodal is keeping up year-over-year gains of 1.8%.

The best week so far this year for intermodal hauls by the top railroads in North America was the week ending July 30, when they loaded 301,393 units of either stackable containers or truck trailers on flatcars.

The continued yearly increases, while mild, show the intermodal sector maintaining strength in August despite evidence that box imports weakened this summer. International container moves make up roughly

60 percent of the boxes that North America's railroads haul, with the rest a mix of domestic containers and trailers.

There continues to be some concerns by railroad economists as the railroads started the year with intermodal growing at a much stronger pace from 2010; for the 33 weeks through Aug. 20 they hauled 6 percent more intermodal volume in 2011 than in the same period last year.

Each year the U.S. continues to see more and more long-distance truck loads utilizing intermodal. When the UP Yermo, CA UP rail/intermodal transload facility comes fully on-line, look for increasing use of intermodal shipments - with transloading occurring inland at major centers such as Chicago and/or near the port facilities such as Yermo or similar type facilities.

Grain Shippers In The Upper Midwest Could Once Again Struggle To Get Containers

If the peak shipping season in the eastbound Pacific is disappointing and the cost of containers remains high - the outlook is for very tight supply - meaning higher prices. In short, the availability will still be there but the prices likely continue to rise.

The difference between this year's market and the equipment shortages of 2010 is that grain shippers will be able to secure the containers they need if they are willing to pay the price, according to industry analysts at the Midwest Shippers Conference held in early August.

Exporters in container-deficient locations such as the upper Midwest and the Pacific Northwest struggle to get enough empty containers even when conditions are normal. A normal environment is marked by strong imports during the peak season, moderately-priced containers and a plentiful supply of empties controlled by ocean carriers and equipment lessors.

Going into the busy export season this fall, the price of a new container is about $3,000, compared to $1,500 in past years.

Container manufacturers in China virtually stopped producing new containers for more than a year during the 2008-09 economic recession. Although factories now are pushing out boxes, container manufacturers are proceeding cautiously because of the soft economies in Europe and the U.S.

Container availability for exporters also depends on a strong peak shipping season in eastbound Pacific because the containers carrying holiday merchandise from Asia are emptied and turned over to exporters. As outlined above in the first article on this TR, imports were weak this summer, indicating the peak shipping season this fall could be disappointing.

Normally, carriers have a plentiful supply of containers on hand, which equates to about 2.5 containers for every slot on the vessels they operate. Carriers traditionally cut back on their equipment supplies during the recession and they now have on average two containers per vessel slot.

According to industry analysts, about 98 percent of containers owned by leasing companies already are leased out, an unprecedented high figure.

STB UPDATE:
DOJ, DOT & USDA HIGHLIGHT THE NEED TO REVIEW LACK OF RAIL COMPETITION, IMPACT ON U.S. EXPORTERS IN EX PARTE NO. 705 - RAIL COMPETITION

In a continuing summary of shipper comments made in the recent Ex Parte 705, Rail Competition proceeding being held at the STB, this Transportation Report covers more of shipper's comments.

The U.S. Departments of Transportation, Justice and Agriculture filed comments about the need for the Surface Transportation Board to take a serious look at how the lack of competition in the railroad industry is hindering U.S. exporters, particularly agricultural shippers.

“These comments underscore the need for the STB to thoroughly examine the lack of competition in the railroad industry and its impact on American manufacturers, farmers and consumers,” said Glenn English, Chairman of Consumers United for Rail Equity, a coalition of rail dependent shippers. “The Agencies are emphasizing the need for a freight rail policy that restores fair, market-based pricing and better access for American companies and the jobs they support.”

Highlights of the DOT, DOJ and USDA comments include:

- Despite the initial success of the Staggers Act, agricultural producers and shippers continue to express concern about decreased rail-to-rail competition, rapidly increasing rail rates, poor rail service, rail capacity constraints and the fair allocation of rail capacity (USDA).
- Almost 75 percent of agricultural crop reporting districts lost rail competition from 1992 to 2007, and the crop reporting districts in which a railroad had a monopoly in transporting grain and oilseeds increased from 10 to 15 percent (USDA).

- The Agencies believe it is appropriate to investigate the extent to which relevant circumstances (such as rail capacity constraints, industry consolidation, and increasing revenue adequacy) have changed, and whether a proper balance of these or other considerations warrants different policy choices (e.g., on rate regulation or access or trackage rights) to serve the same underlying statutory goals (DOT/DOJ).
- To compete effectively in increasingly competitive world markets, U.S. farmers must have access to efficient, reliable, and cost-competitive transportation. The rates agricultural shippers pay for rail transportation must be at a level that promotes, rather than penalizes, American competitiveness in world agricultural markets (USDA).
- Railroad termination of reciprocal switching services and rapid increases in reciprocal switching fees have precluded rail-to-rail competition in many instances (USDA).
- The Board report on rail competition in 2008 estimates that reciprocal switching will have a small effect on railroad profitability and investment incentives. In addition, the report identifies reciprocal switching as one of the methods most likely to result in shipper gains (USDA).
- Although captive shippers bear the brunt of the deregulated industry's differential pricing*, Coal Rate Guidelines, Nationwide,* 1 I.C.C.2d 520,526-27 (1985), the rates and services such shippers receive must nonetheless be "reasonable" and must not reflect an abuse of market power. Yet captive shippers have consistently charged in recent years that their rates and/or services are often unreasonable and that existing precedent often offers them no real protection (DOT/DOJ).

Western Coal Traffic League

The Western Coal Traffic League - in its comments stated: coal traffic is the number one source of rail revenue in the West. Accordingly, one cannot engage in an exploration of the state of rail competition without also conducting a thorough review of the subject of rail competition for coal traffic.

- Following the unprecedented decisions of both BNSF and UP in 2004 to signal their coal pricing and market allocation aspirations to one another through their newly adopted public pricing mediums, coal transportation competition in the West came to an abrupt halt culminating in:
- A 300% + or - rise in the market level for unit coal train transportation rates; The abolition of all meaningful rail service commitments and guarantees for coal shippers;
- The de facto award of monopolist status to the incumbent carrier at every PRB coal-fired facility served by both BNSF and UP at origin and destination (Initial Comments, Richards at 18); and,
- Finally the most illustrative circumstance of all indicating that competition does not exist; Competitive rail coal rates at levels higher than captive rates.
- WCTL also sponsored expert economic testimony from two highly qualified industrial economists. These industrial market experts previously concluded, on the basis of circumstances Nos. 1 through 4, that "strong evidence" exists that BNSF and UP have agreed to stop competing in their pricing and provision of coal transportation service. (Initial Comments, Warren-Boulton /Baseman at 9). WCTL would also note that many other rail shippers are contending in other forums that BNSF and UP have engaged in similar conduct (see In re Rail Freight Fuel Surcharge Antitrust Litigation, -MDL Docket No. 1869, Oxbow v. UP and BNSF, Docket No. 1 l-cv-01049, both pending in federal court in Washington, D.C)
- In conclusion: The rail duopoly in the West, which the agency (STB) authorized over WCTL's repeated opposition, and which has enabled the current circumstances and conditions in the coal transportation market to transpire, cannot now be undone. In other words, the agency is now powerless to meet its statutory obligation to foster railroad competition. Because competition does not and cannot be made to exist by the STB, if railroads refuse to compete when they have the opportunity to do so, the goals of the Staggers Act to protect the interests of the carriers, the shippers, and the public must be realized by other means.

Editor's Note: The sense by captive and many non-captive shippers that were present at the hearing is that the monopoly railroads are dictating both market and dominance in the market place, setting market prices and contributing, according to the U.S.

companies, to U.S. companies losing their competitive position in the market place at home and abroad all-the-while enhancing railroad revenues.